

# Granules India

**BUY**

## Delivery continues

We maintain **BUY** on Granules following another strong quarter which was in-line with our estimates. Our TP is unchanged at Rs 170/sh (12x FY21E EPS).

### HIGHLIGHTS OF THE QUARTER

- The healthy YoY performance in revenue, EBITDA and PAT for 4QFY19 and FY19 was aided by a ramp up in formulations and API supplies with new product launches, expanded capacities, and easing raw material costs over 2HFY19. A sequential decline in EBITDA margin was due to higher R&D expensed off.
- The formulations segment reported another strong quarter (+59% YoY). The API segment (+9.6% YoY) was dragged by a lack of US approvals which led to lower realization from expanded API capacities.
- A planned reduction in domestic API sales (low margin) muted QoQ growth. We expect higher realization on the back of US approvals for new API plants to drive revenue growth of 16% over FY19-21E.
- Gross margin improved 740/150bps YoY/QoQ to 45.9% led by improved product mix and easing RM costs. However, higher R&D spend restricted EBITDA margin expansion (+720/-200bps YoY/QoQ) despite robust oplev. A ramp up in export supplies will enable further ~200bps margin expansion over FY19-21E.

### Financial Summary (Consolidated)

(Rs mn)	4QFY19	4QFY18	YoY (%)	3QFY19	QoQ (%)	FY18	FY19P	FY20E	FY21E
Net Sales	6,133	5,038	21.7	6,318	(2.9)	16,918	22,792	26,688	30,866
EBITDA	976	436	123.7	1,133	(13.9)	2,784	3,840	4,711	5,826
APAT	640	204	213.3	603	6.2	1,326	2,364	2,888	3,541
Adj EPS (Rs)	2.5	1.1	122.1	2.4	6.2	5.2	9.3	11.4	13.9
P/E (x)						21.1	11.8	9.7	7.9
RoE (%)						12.0	16.7	17.5	18.5

Source: Company, HDFC sec Inst Research

- PAT stood at Rs 640mn, up 213/6% YoY/QoQ, aided by a ramp up in profits from JVs at Rs 190mn (+5/8x YoY/QoQ) and lower taxes. Est. 22% CAGR (FY19-21E).
- Net debt remained flat YoY at Rs 8.4bn, down 14% since Sep-18. Cash conversion improved by 22 days to 118 days, aided by lower receivables.
- Near-term outlook:** Further reduction in pledge and approvals for new API plants remain the key triggers.

### STANCE

**As was indicated by the mgmt., Granules has achieved a significant ramp up in revenues (+35% YoY in FY19P) on the back of expanded capacities. While margins remained subdued over the year owing to raw material cost pressures and lack of US approvals for new API plants, better business mix and moderated RM prices will enable a recovery in margins, and the robust revenue growth will also reflect in improved EBITDA/earnings.**

**Granules is out of its capex phase and healthy FCF will enable reduction in debt hereon. The co is also committed to relinquish its pledge (down 17% to 43% of promoter holding since Dec-18), which has been the key overhang on the stock. At 9.7/7.9x FY20/21E EPS, Granules is trading at a ~40% discount to peers. Improving return ratios and steady growth outlook merit a higher multiple.**

INDUSTRY	PHARMA
<b>CMP (as on 10 May 2019)</b>	<b>Rs 110</b>
<b>Target Price</b>	<b>Rs 170</b>
Nifty	11,279
Sensex	37,463

### KEY STOCK DATA

Bloomberg	GRAN IN
No. of Shares (mn)	254
MCap (Rs bn) / (\$ mn)	28/401
6m avg traded value (Rs mn)	148

### STOCK PERFORMANCE (%)

52 Week high / low	Rs 123/72		
	3M	6M	12M
Absolute (%)	27.1	4.7	14.6
Relative (%)	24.6	(1.9)	8.3

### SHAREHOLDING PATTERN (%)

	Dec-18	Mar-19
Promoters	44.87	42.90
FIs & Local MFs	3.04	3.01
FPIs	9.72	12.77
Public & Others	42.37	41.32
Pledged Shares	27.08	18.62

Source : BSE

### AmeY Chalke

amey.chalke@hdfcsec.com  
+91-22-6171-7321

### Eshan Desai

eshan.desai@hdfcsec.com  
+91-22-6639-2476

*Formulations ramp up enabled robust top-line growth of ~22% YoY*

*Better product mix with higher sales of formulations in regulated markets led to improvement in gross margin*

*4QFY18 was a weak quarter due to significant raw material cost hikes*

*Finance cost increased due to higher LIBOR rate during the quarter. Net debt was flat YoY at Rs 8.4bn, down by Rs 1.3bn since Sep-18. Expect further ~Rs 500mn debt reduction in FY20E*

*The mgmt. expects lower capex at Rs 1.5bn in FY20E (v/s Rs 2.7bn for FY19P)*

### Quarterly Financials Snapshot (Consolidated)

Particulars	4QFY19	4QFY18	YoY (%)	3QFY19	QoQ (%)
<b>Net Sales</b>	<b>6,133</b>	<b>5,038</b>	<b>21.7</b>	<b>6,318</b>	<b>(2.9)</b>
Material Expenses	3,316	3,097	7.0	3,592	(7.7)
Employee Expenses	513	424	21.1	536	(4.3)
Other Expenses	1,328	1,081	22.9	1,057	25.7
<b>EBITDA</b>	<b>976</b>	<b>436</b>	<b>123.7</b>	<b>1,133</b>	<b>(13.9)</b>
Depreciation	274	204		270	
<b>EBIT</b>	<b>702</b>	<b>232</b>	<b>202.2</b>	<b>863</b>	<b>(18.7)</b>
Other Income	19	97		59	
Interest Cost	68	62		75	
<b>PBT</b>	<b>652</b>	<b>267</b>	<b>144.4</b>	<b>847</b>	<b>(23.0)</b>
Tax	202	95		265	
Minority Interest	190	32	485.1	21	810.9
<b>PAT</b>	<b>640</b>	<b>204</b>	<b>213.3</b>	<b>603</b>	<b>6.2</b>

Source: Company, HDFC sec Inst Research

### Margin Analysis

	4QFY19	4QFY18	YoY (bps)	3QFY19	QoQ (bps)
Material Expenses % Net Sales	54.1	61.5	(742)	56.8	(279)
Employee Expenses % Net Sales	8.4	8.4	(4)	8.5	(12)
Other Expenses % Net Sales	21.7	21.5	20	16.7	493
<b>EBITDA Margin (%)</b>	<b>15.9</b>	<b>8.7</b>	<b>725</b>	<b>17.9</b>	<b>(202)</b>
Tax Rate (%)	30.9	35.6	(464)	31.2	(30)
APAT Margin (%)	10.4	4.1	638	9.5	89

Source: Company, HDFC sec Inst Research

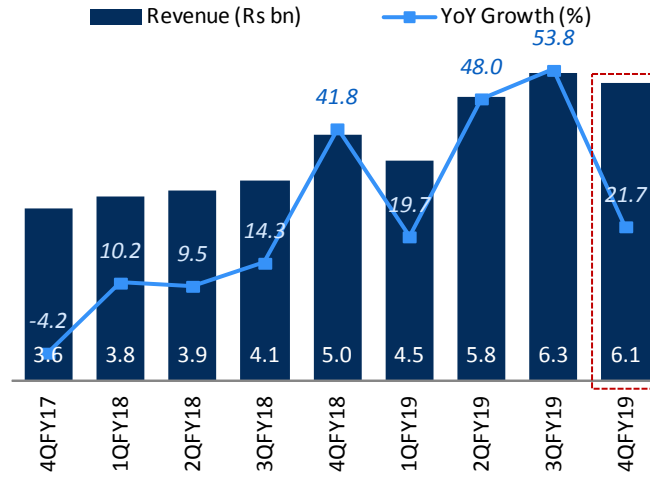
*Sequentially, the revenue declined marginally due to a planned reduction in domestic API sales (as they are low-margin)*

*The formulations segment reported another quarter of robust YoY growth led by higher sales to regulated markets*

*API sales were muted sequentially due to lack of US approvals for new plants*

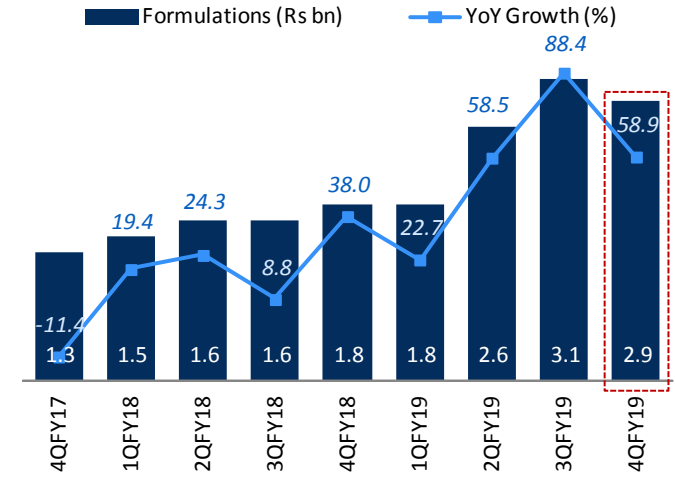
*EBITDA margin was down sequentially due to higher write-off of R&D, and certain one-time provisions*

**Revenue: Robust Double-digit Growth**



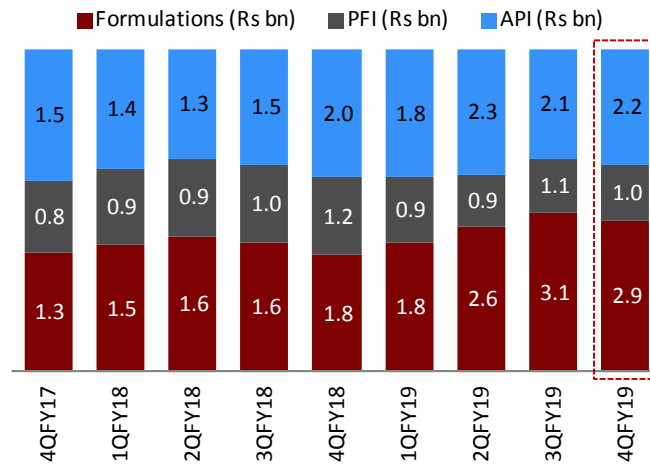
Source: Company, HDFC sec Inst Research

**Formulations: US Drives Strong Ramp-up**



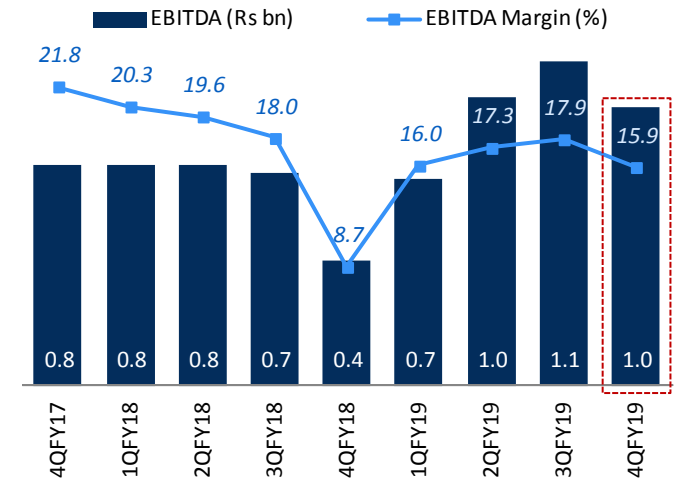
Source: Company, HDFC sec Inst Research

**Mix: Increasing Contribution Of Formulations**



Source: Company, HDFC sec Inst Research

**EBITDA Margin: Sequentially Dragged By R&D**



Source: Company, HDFC sec Inst Research

**Granules has filed 32 ANDAs with the USFDA, 17 of which are filed from GPI (US). Of the 17 from GPI, it has received 2 approvals. The co expects 3-5 approvals and launches in FY20 from GPI**

**API sales are expected to ramp up in FY20E with a likely USFDA approval in 2HFY20**

**The Biocause/Omnichem JV contributed Rs 450/40mn to PAT in FY19 and the co expects healthy performance in FY20E as well**

**The PFI segment is expected to remain muted due to a shift in customer preferences to formulations**

### Segmental Quarterly Performance

(Rs mn)	4QFY19	4QFY18	YoY (%)	3QFY19	QoQ (%)
Finished Dosages	2,883	1,814	58.9	3,096	(6.9)
PFI	1,043	1,209	(13.8)	1,074	(2.9)
API	2,208	2,015	9.6	2,148	2.8
<b>Total</b>	<b>6,133</b>	<b>5,038</b>	<b>21.7</b>	<b>6,318</b>	<b>(2.9)</b>

Source: HDFC sec Inst Research

### Assumptions

Key Segments (Rs mn)	FY17	FY18	FY19P	FY20E	FY21E
Finished Dosages	5,388	6,582	10,760	12,912	15,236
Growth (%)	22.0	22.2	63.5	20.0	18.0
PFI	3,401	4,046	3,870	4,257	4,683
Growth (%)	(11.5)	19.0	(4.4)	10.0	10.0
API	5,380	6,230	8,200	9,519	10,947
Growth (%)	18.6	15.8	31.6	16.1	15.0
<b>Total</b>	<b>14,169</b>	<b>16,858</b>	<b>22,830</b>	<b>26,688</b>	<b>30,866</b>
Growth (%)	1.2	19.0	35.4	16.9	15.7

Source: HDFC sec Inst Research

## Peer Set Comparison

	Mcap (Rs bn)	CMP (Rs/sh)	Reco	TP	Adj EPS (Rs/sh)				P/E (x)				RoE (%)			
					FY18	FY19P	FY20E	FY21E	FY18	FY19P	FY20E	FY21E	FY18	FY19P	FY20E	FY21E
Sun Pharma	1,050	438	BUY	640	13.0	15.3	20.7	27.2	33.7	28.7	21.1	16.1	8.3	9.3	11.7	13.7
Dr Reddy's Labs	478	2,876	BUY	3,400	59.2	109.7	124.4	151.3	48.6	26.2	23.1	19.0	7.8	13.6	13.6	14.3
Cipla	447	556	BUY	630	18.6	16.8	21.1	28.6	29.9	33.1	26.3	19.4	11.2	9.1	10.6	12.9
Aurobindo Pharma	438	748	NEU	800	41.4	42.2	54.1	53.2	18.1	17.7	13.8	14.1	23.0	19.2	20.4	16.8
Divi's Labs	438	1,650	SELL	1,445	32.4	52.4	56.8	65.7	51.0	31.5	29.1	25.1	15.2	21.6	20.2	20.4
Lupin	378	836	BUY	1,060	38.0	15.4	32.5	48.5	22.0	54.2	25.8	17.2	12.7	5.0	10.0	13.6
Cadila Healthcare	296	289	NEU	315	13.0	11.0	13.2	17.5	22.2	26.3	21.9	16.3	17.0	11.9	12.6	14.9
Torrent Pharma	285	1,687	BUY	2,000	40.1	45.8	61.8	83.5	42.1	36.8	27.3	20.2	15.1	15.8	18.6	21.5
Alkem Laboratories	208	1,736	BUY	2,240	57.6	63.4	80.9	101.9	30.1	27.4	21.5	17.0	14.8	14.7	16.6	18.3
Glenmark	174	617	BUY	835	17.5	27.0	33.9	43.7	35.3	22.9	18.2	14.1	9.4	12.7	14.0	15.7
Alembic Pharma	100	532	NEU	570	21.9	25.8	25.1	31.6	24.3	20.6	21.2	16.9	20.0	19.7	16.4	18.1
Jubilant Life Sciences	98	617	BUY	1,005	45.5	58.8	68.6	83.7	13.6	10.5	9.0	7.4	19.3	20.8	20.2	20.5
Strides Shasun	43	486	BUY	570	13.2	6.9	29.3	35.7	36.9	70.7	16.6	13.6	2.9	2.3	9.5	10.7
Laurus Labs	41	385	BUY	535	15.8	10.7	17.0	29.4	24.4	36.0	22.6	13.1	11.9	6.2	10.8	16.7
Suven Life Sciences	33	261	NR	465	9.7	5.6	9.8	11.3	26.9	46.7	26.6	23.2	17.2	8.9	14.2	14.5
Dishman Carbogen Amcis	33	204	BUY	400	13.2	15.7	20.9	26.7	15.4	13.0	9.8	7.6	14.6	15.0	16.7	18.1
J B Chemicals & Pharmaceuticals	29	364	NR	470	16.6	23.8	28.4	33.6	22.0	15.3	12.8	10.8	9.9	13.2	14.8	15.4
<b>Granules India</b>	<b>28</b>	<b>110</b>	<b>BUY</b>	<b>170</b>	<b>5.2</b>	<b>9.3</b>	<b>11.4</b>	<b>13.9</b>	<b>21.1</b>	<b>11.8</b>	<b>9.7</b>	<b>7.9</b>	<b>12.0</b>	<b>16.7</b>	<b>17.5</b>	<b>18.5</b>
Neuland Labs	9	671	BUY	930	10.8	10.8	37.5	66.5	62.1	62.0	17.9	10.1	2.2	2.2	6.7	11.0

Source: HDFC sec Inst Research

## Change In Estimates (Consolidated)

Rs mn	Previous			New			Change (%)		
	FY19P	FY20E	FY21E	FY19P	FY20E	FY21E	FY19P	FY20E	FY21E
Revenue	22,724	26,450	30,569	22,792	26,688	30,866	0.3	0.9	1.0
EBITDA	3,936	4,760	5,859	3,840	4,711	5,826	(2.4)	(1.0)	(0.6)
APAT	2,340	2,866	3,605	2,364	2,888	3,541	1.0	0.8	(1.8)

Source: HDFC sec Inst Research

**Income Statement (Consolidated)**

Year ending March (Rs mn)	FY17	FY18	FY19P	FY20E	FY21E
<b>Net Revenues</b>	<b>14,353</b>	<b>16,918</b>	<b>22,792</b>	<b>26,688</b>	<b>30,866</b>
<b>Growth (%)</b>	<b>5.8</b>	<b>17.9</b>	<b>34.7</b>	<b>17.1</b>	<b>15.7</b>
Material Expenses	6,796	8,963	12,556	13,878	15,741
Employee Expenses	1,402	1,652	2,098	2,535	2,871
Other Expenses	3,166	3,519	4,298	5,564	6,428
<b>EBITDA</b>	<b>2,988</b>	<b>2,784</b>	<b>3,840</b>	<b>4,711</b>	<b>5,826</b>
<b>EBITDA Margin (%)</b>	<b>20.8</b>	<b>16.5</b>	<b>16.8</b>	<b>17.7</b>	<b>18.9</b>
<b>EBITDA Growth (%)</b>	<b>8.2</b>	<b>(6.8)</b>	<b>37.9</b>	<b>22.7</b>	<b>23.7</b>
Depreciation	715	762	1,055	1,236	1,461
<b>EBIT</b>	<b>2,273</b>	<b>2,022</b>	<b>2,786</b>	<b>3,475</b>	<b>4,365</b>
Other Income (Including EO Items)	99	108	267	133	154
Interest	323	331	285	269	246
<b>PBT</b>	<b>2,050</b>	<b>1,800</b>	<b>2,768</b>	<b>3,340</b>	<b>4,273</b>
Tax (Incl Deferred)	652	634	891	1,002	1,282
Minority Interest / Share of profit	247	160	487	550	550
<b>PAT</b>	<b>1,645</b>	<b>1,326</b>	<b>2,364</b>	<b>2,888</b>	<b>3,541</b>
<b>PAT Growth (%)</b>	<b>29.8</b>	<b>(19.4)</b>	<b>78.3</b>	<b>22.2</b>	<b>22.6</b>
<b>Adjusted EPS (Rs)</b>	<b>7.5</b>	<b>5.2</b>	<b>9.3</b>	<b>11.4</b>	<b>13.9</b>

Source: Company, HDFC sec Inst Research

**Balance Sheet (Consolidated)**

Year ending March (Rs mn)	FY17	FY18	FY19P	FY20E	FY21E
<b>SOURCES OF FUNDS</b>					
Share Capital - Equity	229	254	254	254	254
Reserves	8,807	12,788	15,040	17,427	20,450
<b>Total Shareholders Funds</b>	<b>9,036</b>	<b>13,042</b>	<b>15,295</b>	<b>17,681</b>	<b>20,705</b>
Long Term Debt	1,242	4,331	3,780	3,080	2,465
Short Term Debt	4,738	5,251	5,550	5,500	5,365
<b>Total Debt</b>	<b>5,981</b>	<b>9,582</b>	<b>9,330</b>	<b>8,580</b>	<b>7,830</b>
<b>Net Deferred Taxes</b>	<b>565</b>	<b>474</b>	<b>613</b>	<b>519</b>	<b>528</b>
<b>Other Non-current Liabilities &amp; Provns</b>	<b>39</b>	<b>24</b>	<b>79</b>	<b>87</b>	<b>96</b>
<b>TOTAL SOURCES OF FUNDS</b>	<b>15,620</b>	<b>23,121</b>	<b>25,316</b>	<b>26,867</b>	<b>29,158</b>
<b>APPLICATION OF FUNDS</b>					
Net Block	6,443	7,767	9,442	11,707	12,746
CWIP	2,674	5,145	4,960	3,000	2,000
Investments	1,082	1,566	2,104	2,104	2,104
Other Non-current Assets	306	359	457	503	553
<b>Total Non-current Assets</b>	<b>10,506</b>	<b>14,837</b>	<b>16,963</b>	<b>17,314</b>	<b>17,404</b>
<b>Cash &amp; Equivalents</b>	<b>498</b>	<b>1,156</b>	<b>890</b>	<b>1,114</b>	<b>1,984</b>
Inventories	2,692	2,799	3,842	4,455	5,076
Debtors	4,177	6,171	6,735	8,043	9,302
Other Current Assets	915	1,406	1,354	1,586	1,834
<b>Total Current Assets</b>	<b>7,784</b>	<b>10,376</b>	<b>11,932</b>	<b>14,084</b>	<b>16,213</b>
Creditors	2,160	2,522	3,235	4,215	4,802
Other Current Liabilities & Provns	1,007	726	1,235	1,430	1,640
<b>Total Current Liabilities</b>	<b>3,167</b>	<b>3,248</b>	<b>4,469</b>	<b>5,645</b>	<b>6,442</b>
<b>Net Current Assets</b>	<b>4,617</b>	<b>7,128</b>	<b>7,463</b>	<b>8,439</b>	<b>9,770</b>
<b>TOTAL APPLICATION OF FUNDS</b>	<b>15,620</b>	<b>23,121</b>	<b>25,316</b>	<b>26,867</b>	<b>29,158</b>

Source: Company, HDFC sec Inst Research

**Cash Flow (Consolidated)**

Year ending March (Rs mn)	FY17	FY18	FY19P	FY20E	FY21E
Reported PBT	2,050	1,800	2,768	3,340	4,273
Non-operating & EO items	(42)	13	-	-	-
Interest expenses	278	300	18	135	92
Depreciation	715	762	1,055	1,236	1,461
Working Capital Change	(524)	(2,300)	(279)	(644)	(1,316)
Tax Paid	(595)	(581)	(891)	(1,002)	(1,282)
<b>OPERATING CASH FLOW ( a )</b>	<b>1,882</b>	<b>(7)</b>	<b>2,670</b>	<b>3,065</b>	<b>3,228</b>
Capex	(3,157)	(4,463)	(2,544)	(1,540)	(1,500)
Free cash flow (FCF)	(1,274)	(4,469)	126	1,525	1,728
Non-operating Income	(104)	(160)	(272)	133	154
<b>INVESTING CASH FLOW ( b )</b>	<b>(3,261)</b>	<b>(4,623)</b>	<b>(2,816)</b>	<b>(1,407)</b>	<b>(1,346)</b>
Debt Issuance/(Repaid)	272	2,960	(252)	(750)	(750)
Interest Expenses	(319)	(314)	(285)	(269)	(246)
FCFE	(1,321)	(1,823)	(411)	506	732
Share Capital Issuance	829	2,930	0	-	-
Dividend	(223)	(290)	(304)	(502)	(517)
Others	14	2	721	86	502
<b>FINANCING CASH FLOW ( c )</b>	<b>573</b>	<b>5,288</b>	<b>(120)</b>	<b>(1,435)</b>	<b>(1,011)</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>(806)</b>	<b>659</b>	<b>(266)</b>	<b>224</b>	<b>871</b>
<b>Closing Cash &amp; Equivalents</b>	<b>497</b>	<b>1,157</b>	<b>890</b>	<b>1,114</b>	<b>1,984</b>

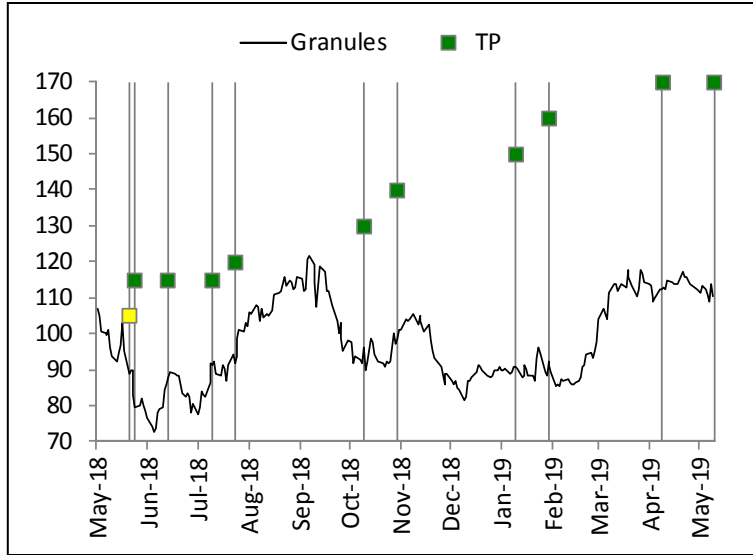
Source: Company, HDFC sec Inst Research

**Key Ratios**

	FY17	FY18	FY19P	FY20E	FY21E
<b>PROFITABILITY (%)</b>					
GPM	52.6	47.0	44.9	48.0	49.0
EBITDA Margin	20.8	16.5	16.8	17.7	18.9
APAT Margin	11.5	7.8	10.4	10.8	11.5
RoE	21.0	12.0	16.7	17.5	18.5
RoIC (or Core RoCE)	12.7	7.8	9.0	10.8	12.8
RoCE	13.1	8.0	10.6	11.8	13.3
<b>EFFICIENCY</b>					
Tax Rate (%)	31.8	35.2	32.2	30.0	30.0
Fixed Asset Turnover (x)	1.5	1.4	1.5	1.5	1.5
Inventory (days)	68.5	60.4	61.5	60.9	60.0
Debtors (days)	106.2	133.1	107.9	110.0	110.0
Other Current Assets (days)	23.3	30.3	21.7	21.7	21.7
Payables (days)	54.9	54.4	51.8	57.6	56.8
Other Current Liab & Provns (days)	25.6	15.7	19.8	19.6	19.4
Cash Conversion Cycle (days)	117.4	153.8	119.5	115.4	115.5
Debt/EBITDA (x)	2.0	3.4	2.4	1.8	1.3
Net D/E (x)	0.6	0.6	0.6	0.4	0.3
Interest Coverage (x)	7.0	6.1	9.8	12.9	17.7
<b>PER SHARE DATA (Rs)</b>					
EPS	7.5	5.2	9.3	11.4	13.9
Dividend	0.8	1.1	1.0	1.7	1.7
Book Value	35.5	51.3	60.2	69.5	81.4
<b>VALUATION</b>					
P/E (x)	14.6	21.1	11.8	9.7	7.9
P/BV (x)	3.1	2.1	1.8	1.6	1.4
EV/EBITDA (x)	10.3	13.1	9.5	7.5	5.8
EV/Revenues (x)	2.1	2.1	1.6	1.3	1.1
OCF/EV (%)	6.1	(0.0)	7.3	8.7	9.5
FCF/EV (%)	(4.2)	(12.3)	0.3	4.3	5.1
FCFE/Mkt Cap (%)	(5.3)	(6.5)	(1.5)	1.8	2.6
Dividend Yield (%)	0.7	1.0	0.9	1.5	1.5

Source: Company, HDFC sec Inst Research

**RECOMMENDATION HISTORY**



Date	CMP	Reco	Target
21-May-18	95	NEU	105
25-May-18	83	BUY	115
13-Jun-18	85	BUY	115
10-Jul-18	86	BUY	115
25-Jul-18	92	BUY	120
10-Oct-18	93	BUY	130
31-Oct-18	97	BUY	140
10-Jan-19	90	BUY	150
31-Jan-19	92	BUY	160
9-Apr-19	112	BUY	170
13-May-19	110	BUY	170

**Rating Definitions**

- BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
- NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
- SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period



## INSTITUTIONAL RESEARCH

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**HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066**

**Compliance Officer: Binkle R. Oza Email: [complianceofficer@hdfcsec.com](mailto:complianceofficer@hdfcsec.com) Phone: (022) 3045 3600**

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**HDFC securities**

**Institutional Equities**

Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park,

Senapati Bapat Marg, Lower Parel, Mumbai - 400 013

Board : +91-22-6171-7330 [www.hdfcsec.com](http://www.hdfcsec.com)